

Internal Revenue Service

**memorandum**

CC:TL:TS/P

ESHATZ

date: APR 10 1991

to: District Counsel, Houston  
Attn: Shari Wilcox

from: Chief Tax Shelter/Partnerships Branch CC:TL:TSP

subject:

TL-N-4184-91

Shatz Wilson Houston

I.R.C. § 6229(f), 6501(h), 6501(i)

This is in response to your request for tax litigation advice dated February 26, 1991.

ISSUE

Whether the additional tax due is attributable to the partnership items converted to nonpartnership items, in which case the period for assessment has expired pursuant to I.R.C. § 6229(f), or whether the additional tax due is attributable to the disallowance of the nonpartnership net operating losses and foreign tax credit carrybacks, which would permit assessment under section 6501(h) and (i).

CONCLUSION

For the reasons discussed below, we conclude the adjustment is attributable to the disallowance of the net operating losses and foreign tax credit carrybacks for the open years before the court. Therefore, assessment of the tax attributable to those items is permissible under sections 6501(h) and (i).

FACTS

[REDACTED], a subsidiary of [REDACTED], was a partner in [REDACTED] (the Joint Venture), a TEFRA partnership. On [REDACTED], [REDACTED] executed Forms 870-P with respect to the joint venture's [REDACTED] through [REDACTED] taxable years. The agreement was countersigned by the Service on [REDACTED]. [REDACTED]'s pro rata portion

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of the increase in partnership income was as follows: \$ [REDACTED] for [REDACTED], \$ [REDACTED] for [REDACTED], and \$ [REDACTED] for [REDACTED]. Pursuant to I.R.C. § 6231(b)(1)(C), the execution of the settlement agreement converted [REDACTED]'s partnership items to nonpartnership items.

At the request of the Austin Service Center, Examination computed the tax due as a result of the additional partnership income. Although nonpartnership net operating losses and foreign tax credit carrybacks had been generated at the time the computations were made, the years generating the losses and credits had not yet been audited. Therefore, when offset against the additional income from the TEFRA adjustment, the result was no deficiency for [REDACTED], [REDACTED] and [REDACTED]. A small deficiency for [REDACTED] and restricted interest for [REDACTED] was timely assessed on [REDACTED].

On [REDACTED], a notice of deficiency was mailed to [REDACTED] for the years [REDACTED] through [REDACTED]. The statutory notice disallowed the net operating losses and foreign tax credits claimed on [REDACTED]'s returns which had previously been used to offset the TEFRA adjustments, resulting in deficiencies for the years [REDACTED] through [REDACTED]. [REDACTED] has filed a petition in the Tax Court on the notice.

You have requested our advice as to whether the statute of limitations under I.R.C. § 6229(f), which expired on [REDACTED], for the tax resulting from adjustments to income for the [REDACTED]-[REDACTED] Joint Venture tax years, precludes assessment of deficiencies which arise in those years due to the disallowance of the carrybacks.

#### ANALYSIS

The primary issue raised is whether the additional tax due is attributable to the partnership items converted to nonpartnership items, in which case the one year period for assessment has expired pursuant to I.R.C. § 6229(f)1/, or whether the additional tax due is attributable to the disallowance of the nonpartnership net operating losses and foreign tax credit carrybacks, which would permit assessment under section 6501(h) and (i). For the reasons discussed below, we conclude that the

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1/ Section 6229(f) provides that the period of limitations with respect to converted partnership items is one year from the date on which the items become nonpartnership items. In this instance the period expired on [REDACTED], one year from the date the settlement agreements were countersigned by the Service.

additional tax is attributable to the net operating losses and foreign tax credit carrybacks currently before the court rather than attributable to the converted partnership items. As a result, assessment of any deficiencies is not precluded by the expiration of the period of limitations under I.R.C. § 6229(f).

At the outset it should be noted that the original computation of the deficiency raises the converse of the situation addressed by the Tax Court in Munro v. Commissioner, 92 T.C. 71 (1989). In Munro, the Tax Court upheld the validity of a statutory notice of deficiency that disallowed TEFRA partnership losses instead of eliminating them from the return in computing the deficiency in the statutory notice. Although it upheld the validity of the notice, the court ruled that it was impermissible for the Service to disallow TEFRA partnership losses in the statutory notice, even if this was done solely for computational purposes and was not intended to be a substitute for issuing a notice of Final Partnership Administrative Adjustment (FPAA) as required by section 6225. More importantly, the court held that TEFRA partnership items (whether income, loss, deductions or credits) included on a taxpayer's return should be completely ignored in determining whether a deficiency exists that is attributable to nonpartnership items.

Under the facts of Munro, unlike the facts in this case, the TEFRA proceeding was not complete at the time the statutory notice was issued in the non-TEFRA proceeding. However, the rationale of Munro is arguably applicable to situations in which the TEFRA proceeding is completed prior to the statutory notice proceeding. As the court emphasized in Munro, the TEFRA provisions and the statutory notice provisions are entirely separate, "All partnership items must be separated from nonpartnership items and are exclusively the subject of a partnership proceeding. Deficiency proceedings must exclusively consider nonpartnership items...." Munro at 74, See also Maxwell v. Commissioner, 87 T.C. 783, 788 (1986). Therefore, the court might conclude in a case such as this that a deficiency attributable to the increased partnership income should be calculated without reference to the nonpartnership net operating losses and foreign tax credit carrybacks. In this case, such an approach would preclude assessment of the additional tax because the TEFRA proceeding is completed and the one year assessment period for converted items under section 6229(f) has expired.

Several arguments can be made for distinguishing the court's opinion in Munro from the facts presented in this case. Unlike the scenario presented in Munro in which the final determination of the TEFRA items had not yet been made, in this case the

settlement agreement sets forth the agreed final determination of the TEFRA items. Therefore, the deficiencies currently at issue as a result of the nonpartnership audit can and should be computed with reference to the TEFRA adjustments. In addition, with regard to the original computation made prior to the nonpartnership audit, the situation presented in Munro did not involve nonpartnership items that were not the subject of an ongoing proceeding. Therefore, we believe that the Munro requirement for independent computations is not applicable in situations such as this in which the nonpartnership items were accepted as reported.

Further support for limiting Munro in this instance lies in the nature of carrybacks. Unless the Munro computation excludes only nonpartnership items arising in the same taxable year, a taxpayer is denied the benefit of a carryback arising in a later year until the loss year is closed. Such a result is inconsistent with the policy underlying the carryback provisions of the Code which permit taxpayers to take advantage in prior years of currently unusable losses and credits. As discussed below, I.R.C. §§ 6501(h) and (i) provide a mechanism for adjusting the carryback year in the event the loss is subsequently disallowed, and therefore excluding the carryback amount from the Munro computation is not necessary to protect the government's interest.

We conclude that Munro is inapplicable to this case in any event because the additional tax is attributable to the disallowance of the nonpartnership net operating loss carrybacks and foreign tax credit carrybacks rather than to the partnership items. This conclusion is supported by sections 6501(h) and (i) of the Code. Section 6501(h) provides that "In the case of a deficiency attributable to the application to the taxpayer of a net operating loss carryback..., such deficiency may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the net operating loss...which results in such carryback may be assessed."<sup>2/</sup> As the Tax Court recently stated in Calumet Industries Inc. v. Commissioner, 95 T.C. 257, 272:

"... if the year in which the NOL arose is open, then the year to which the NOL is carried back is also open for purposes of assessing a deficiency attributable to

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<sup>2/</sup> Section 6501(i) provides that the statute remains open for the prior years until one year after the expiration of the year in which the excess taxes are claimed. Because the case law has generally concerned NOL's, our analysis will focus on 6501(h). However, the same analysis applies with respect to the foreign tax credit carrybacks.

the carryback. Section 6501(h) effectively extends the assessment period for a deficiency that is based on the disallowance of an erroneous or improper loss carryback until the assessment period for the tax year of the loss has expired. Without section 6501(h), the assessment period for the carryback year would likely be closed or closing about the time the NOL deduction is being carried back." Calumet at 272-273.

Citing the legislative history of section 276(d), the predecessor of section 6501(h), the court concluded:

The legislative history contains the reasoning that "the events which give rise ... to deficiencies attributable to carry-backs do not occur until after the close of the taxable year, and in some cases may not occur until a considerable number of years thereafter." H.Rept. 849, 79th Cong., 1st Sess. 29 (1945), 1945 C.B. 566, 585. Consequently, the Government generally did not have available, under prior law, the information necessary to make an assessment for deficiencies resulting from carrybacks during part or all of the 3 year period within which such assessment was to be made. Accordingly, section 6501(h) and its predecessor, section 276(d), were enacted to provide the Government with a longer period to determine and assess a deficiency attributable to an NOL carryback. H. Rept. 849, supra.

Calumet at 278.

Based on the policy set forth in the legislative history and affirmed by the Tax Court, we conclude that the facts of this case support the application of section 6501(h), and by analogy, section 6501(i). Crucial to the applicability of section 6501(h) is the requirement that the additional tax due is attributable to the carryback with respect to which such amount was applied, credited or refunded. While neither the Code nor the regulations adequately define the parameters of the term "attributable to", several opinions of the Tax Court give some indication of the scope of the term. United Surgical Steel v. Commissioner, 54 T.C. 1215 (1970); Leuthesser v. Commissioner, 18 T.C. 1112, 1125 (1952); See also Bouchey v. Commissioner, 19 T.C. 1078 (1953); and Bunn's Auto Sales Inc. v. Commissioner, 35 T.C. 861 (1961).

In United Surgical Steel, the petitioner's returns for the 1962, 1963 and 1964 taxable years were examined, and the Service disallowed any deductions for a reserve for bad debts on account of guaranteed debt obligations. The Service's determination was accepted by the petitioner on February 1, 1966, and the deficiencies were assessed on April 1, 1966. The deficiencies were offset by the net operating loss carryback from the petitioner's 1965 and 1966 taxable years. The subsequent disallowance of the carryback resulted in the issuance of a statutory notice of deficiency in 1968 for the petitioner's 1962, 1963 and 1964 taxable years. On these facts the court concluded that although the statute of limitations generally barred the assessment of the deficiencies for the 1962 and 1963 years, the additional period for assessing the deficiencies remained open because the proposed deficiencies were attributable to the application of the net operating loss carryback. United Surgical Steel at 1226.3/

Thus, regardless of the application of the separate procedures doctrine set forth in Munro, the court's opinion in United Surgical Steel strongly supports our conclusion that the proposed deficiencies in this case are attributable to the carrybacks rather than the partnership items.<sup>4/</sup> The additional tax is directly linked to the fact that but for the use of the NOL and foreign tax credit carrybacks, the inclusion of the TEFRA adjusted partnership income would have resulted in the timely assessment of the deficiency. Therefore, despite the potential hazards raised by the court's opinion in Munro, we recommend defense of the adjustments in the years at issue. The facts strongly parallel those viewed favorably by the court in United Surgical Steel, and the legislative history of section 6501(h)

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3/ But cf. Leuthesser v. Commissioner, in which the Tax Court rejected the Service's argument that the net operating loss carryback provisions permitted the correction of an error in a carryback year unrelated to the circumstances giving rise to the carryback. In so holding, the court stated, "Of course, if the refund were erroneous by reason of an incorrect application of the carry-back adjustments...or by reason of an incorrect determination of the amount or existence of losses giving rise to the carry-back, then plainly respondent's position would be sound. For, such were the very types of situations which the legislation was intended to govern." Leuthesser at 1125. See also Bouchev v. Commissioner, 19 T.C. 1078 (1953).

4/ Cf. Woody v. Commissioner, 95 T.C. 193 (1990) (court narrowly reads phrase "attributable to" concluding that claimed overpayment was attributable to an affected item properly before court under 6512(b)).

and the policy underlying the Code provisions support the conclusion that the years in question should remain open for the purpose of assessing deficiencies previously offset by the net operating loss carrybacks and foreign tax credit carrybacks.

Should you have any further questions regarding this matter, please contact Eileen Shatz at FTS 566-4369.



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